BANK OF ENGLAND

HM TREASURY

News release

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Bank of England and HM Treasury announce launch of Funding for Lending Scheme

The Bank of England and HM Treasury are today announcing the launch of the Funding for Lending Scheme (FLS). The FLS is designed to boost lending to the real economy. Banks and building societies that increase lending to UK households and businesses will be able to borrow more in the FLS, and do so at lower cost than those that scale back lending.

The introduction of the FLS occurs against the backdrop of a euro-area debt crisis which has revealed severe vulnerabilities in the European banking system and has led to a marked deterioration in the outlook for the UK economy over the past twelve months. In spite of the policy actions of the authorities, the flow of credit through the banking system – which households and many businesses necessarily rely on – has remained impaired. The FLS is designed to tackle this problem by reducing the price at which banks and building societies are able to fund themselves.

In the publication of an exchange of letters between the Governor and the Chancellor, accompanied by a background Explanatory Note and a Market Notice, the Bank and HM Treasury have today outlined the design and operation of the FLS. From today, eligible banks and building societies are encouraged to ensure they build up sufficient eligible collateral pre-positioned with the Bank to support their future use of the scheme. The FLS will open for drawings on 1 August. For 18 months thereafter, banks and building societies will be able to borrow UK Treasury Bills from the Bank for a period of up to 4 years against DWF-eligible collateral, for a fee.

Participating banks and building societies will be able to borrow up to 5% of their stock of existing lending to the real economy, plus any net expansion of lending during a reference period (from end-June 2012 to end-December 2013). In other words, for every pound of additional real economy lending an institution advances, an additional pound of access to the scheme will be permitted for that institution. There is no upper limit on the size of either individual or aggregate borrowing under the scheme. By way of illustration, 5% of the stock of existing loans is equivalent to roughly £80bn across all potentially eligible banks and building societies.

The price of each institution's borrowing in the FLS will depend on its volume of lending to the real economy during the reference period. For banks or building societies maintaining or expanding their lending over that period, the fee will be 0.25% pa on the amount borrowed. After accounting for the cost of using the T-bills to borrow money, the total cost of funding for an institution using the FLS will be lower than current term funding rates, even for the strongest institutions. So as banks increase lending, their overall funding costs will fall. For banks or building societies whose lending declines, the fee will increase linearly, up to a maximum of 1.5% pa where lending decreases by 5% or more.

The FLS is designed to encourage broad participation so that as many institutions as possible have incentives to lend more to the UK real economy through, for example, business loans and residential mortgages, than they otherwise would have. Access to the scheme will be for those banks and building societies who sign up for the Bank's Discount Window Facility. Institutions will be permitted additional access to the scheme, pound-for-pound with any increase in lending, provided they have sufficient DWF-eligible collateral. The amount borrowed from the Bank of England, and the amount lent to households and firms, by each participating institution will be made public by the Bank of England on a quarterly basis.

Although the Bank will not be indemnified for the operation of the FLS, the exchange of letters published today shows that the Bank has sought and received an assurance from the Government that the objectives of the Scheme lie within its remit. In addition, the FLS will be overseen by a joint Bank / HMT Oversight Board, which will meet on a quarterly basis.

Commenting on the launch of the Scheme, the Governor of the Bank of England said: "This joint action by the Bank and the Treasury creates strong incentives for banks to expand their lending to the real economy. The more banks expand lending, the more they can use the Scheme. That will encourage banks to make loans to families and businesses both cheaper and more easily available". The Chancellor of the Exchequer said: "Today's announcements aim to make mortgages and loans cheaper and more easily available, providing welcome support to businesses that want to expand and families aspiring to own their own home. The Treasury and the Bank of England are taking coordinated action to inject new confidence into our financial system and support the flow of credit to where it is needed in the real economy – showing that we are not powerless to act in the face of the eurozone debt storm."

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Notes for Editors

1. The letter from the Governor of the Bank of England to the Chancellor of the Exchequer can be accessed here: http://www.bankofengland.co.uk/monetarypolicy/documents/pdf/govletter120713.pdf

2. The letter from the Chancellor of the Exchequer to the Governor of the Bank of England can be accessed here: http://www.hm-treasury.gov.uk/d/chx_letter_130712.pdf

3. The Explanatory Note can be accessed here: www.bankofengland.co.uk/markets/Documents/explanatory_notefls120713.pdf

4. The Market Notice can be accessed here: http://www.bankofengland.co.uk/markets/Documents/marketnotice120713.pdf